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SIPDIS

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EUR/ACE FOR MARIA LONGI
DEPT FOR USAID

SENSITIVE

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SUBJECT: USATF MID-TERM REVIEW FOCUSES ON CUSTOMS,
TAXATION ISSUES

11. (U) Sensitive But Unclassified. Please treat accordingly.

12. (SBU) The March 1 meeting of the U.S.-Armenia Task Force on Economic Cooperation (USATF) mid-term review focused on issues related to corruption, U.S. technical assistance in the private sector, improving customs procedures, trafficking in persons and INL-related issues. Frank discussion of GOAM misgivings over aspects of the USG energy efficiency assistance ended with an agreement to establish a working group to address specific concerns. Both parties tentatively agreed to hold the next USATF meeting in Armenia on or about May 18-19 to accommodate the schedules of Washington visitors from EUR/ACE. End Summary.

USATF ON CORRUPTION, SME DEVELOPMENT, BUSINESS CLIMATE

13. (SBU) Ambassador Ordway co-chaired the March 1 USATF mid-term review meeting with GOAM Minister of Finance and Economy Vartan Khachatryan. The two sides signed the final version of the USATF Action Plan from the November 2003 meeting of the USATF in Washington, D.C. (see paragraph 13 for full text). The Ambassador previewed overall USG comments on the GOAM's recently unveiled anti-corruption (A-C) strategy and accompanying action plan and informed the GOAM that USG representatives (including USAID and State) would provide these comments to GOAM officials for future discussion. He also mentioned the compilation of a USG inventory of ongoing USG technical assistance related to A-C. Minister Khachatryan agreed to consider the USG comments and integrate them into future A-C programming (USATF Action Plan Item 5).

14. (SBU) Following an in-depth discussion of USAID and USDA technical assistance for small and medium-sized enterprises (SMEs), Minister Khachatryan called on the USG to continue its program of establishing credit clubs that benefit SMEs in rural areas. Minister Khachatryan complained about a perceived lack of coordination with the EBRD regarding Armenia's economic needs. USAID responded that it had met recently with EBRD officials regarding deepening the organization's programs in Armenia. The Ambassador outlined EBRD plans for a permanent expatriate representative in Armenia and predicted better collaboration once the EBRD re-established a full-scale Yerevan office (USATF Action Plan Item 6).

15. (SBU) USAID informed the USATF that it was in contract negotiations with the American Chamber of Commerce in Armenia to conduct the planned Business Climate Review. The GOAM requested that the USG share the terms of reference for the study with the Ministry of Finance and Economy. Both sides discussed ways to ensure that the study would complement ongoing studies and reports sponsored by the World Bank (USATF Action Plan Item 7).

SENSITIVITIES OVER ENERGY EFFICIENCY PROGRAMS

16. (SBU) A review of pending customs cases revealed misperceptions and reservations by the GOAM regarding some of USAID's ongoing energy efficiency programs. Minister Khachatryan said the GOAM was wary of a specific heating and cooling initiative that appeared to benefit wealthy Armenians instead of Armenia's poorest communities. He said that the GOAM was holding equipment related to this program at the border until the USG provided further information about the design of the program and its beneficiaries. Ambassador Ordway condemned this practice as damaging to our bilateral assistance relationship and called on the GOAM to release commodities immediately. The two sides

agreed to a working group meeting to further educate the Ministries of Energy and Finance and Economy about USAID's energy efficiency programs in order to avoid similar problems in the future (USATF Action Plan Item 11).

CUSTOMS PROCEDURES AND TAXATION OF USG ASSISTANCE

17. (SBU) The USG detailed other cases of commodities that the GOAM was holding at the port of entry pending customs clearance. Ambassador Ordway reminded the GOAM of USG legislation forbidding the taxation of USG assistance and ongoing USG efforts to secure buy-in from GOAM stakeholders including relevant ministries and government offices to avoid such delays. Both sides acknowledged new procedures agreed to during the November USATF meeting and agreed to consult with government counterparts in the event of discrepancies. The USG reviewed the mostly positive (preliminary) results from Embassy Yerevan of the 2003 "Section 579" report on taxation of government assistance. Ambassador Ordway called on the MFE to look for ways to expedite reimbursement of VAT paid by implementing offices or USG offices (USATF Action Plan Items 22 and 23).

FORENSIC LABORATORY, MONEY LAUNDERING, RULE OF LAW

18. (SBU) Following discussion among GOAM representatives over which ministry should have technical oversight of the INL-sponsored Forensic Lab Project, the GOAM suggested the organization of a new internal task force to address the issue. DCM and INL representative Ed Schack agreed to meet with the interministerial group in late March to monitor progress on this issue (USATF Action Plan Items 13 and 14).

19. (SBU) The GOAM agreed to provide copies of two recent anti-money laundering draft laws to the Embassy within the month. The USG will translate the laws into English and provide them to INL anti-money laundering experts in Washington for comment (USATF Action Plan Item 16). The Ambassador discussed the status of USG assistance in the judicial sector. He reported that USAID was considering reinstating programs in this sector that could include a national code of ethics and technical assistance in case management (USATF Action Plan Item 16).

TRAFFICKING IN PERSONS

10. (SBU) DCM expressed USG disappointment in the inadequate GOAM anti-trafficking efforts over the past year and warned the GOAM of the risk of classification as a Tier 3 country in the Department's Trafficking in Persons Report. The USG called on the GOAM to take greater ownership of the issue in order to avoid possible negative consequences that could include sanctions.

COMMENT

11. (SBU) The four months following the last USATF meeting did not leave sufficient time for implementation of Action Plan items. The mid-term review had the effect, however, of reminding GOAM ministries of their November 2003 commitments and encouraging dialogue with USG counterparts to produce measurable results before the next USATF meeting in late May. Minister Khachatryan appears increasingly comfortable in his role as USATF facilitator and moderator among counterparts in other ministries. We should capitalize on this dynamic by crafting a succinct, more action-oriented Action Plan during the next USATF meeting that will clearly define required actions and allow Minister Khachatryan to more effectively hold his colleagues to their end of USATF agreements. Despite tensions over customs issues, the USATF mechanism continues to prove its worth as our principal forum for dialogue on bilateral assistance issues.

12. (U) Point of contact is Embassy Assistance Coordinator Aaron Sherinian (SherinianAH@state.gov). Additional copies of the Action Plan and supporting briefing memos from the mid-term review have been sent to the Department (EUR/CACEN and EUR/ACE).

FINAL TEXT OF USATF ACTION PLAN

13. (U) The final text of the USATF Action Plan (as signed by Ambassador Ordway and Minister Khachatryan) follows. Begin text:

-- Action Plan
-- U.S.-Armenia Economic Task Force
-- November 4-5, 2003

(1) The U.S. Government recognizes the linkages between the newly adopted Poverty Reduction Strategy, anti-corruption, and economic development, and congratulates the Government of Armenia in finalizing its PRSP in August 2003. The U.S. Government will coordinate with the Government of Armenia as we develop our monitoring plan to ensure that it can also measure contributions to PRSP goals.

(2) The U.S. Government supports the concepts in the PRSP on targeting social payments, creating jobs, and investing in education and health. Both sides also recognize that it is critical to increase savings in the economy and allowing for the creation of basic conditions for increased investment.

(3) The U.S. Government recognizes and applauds Armenia's strong macroeconomic performance in the past few years. However, both sides agree on the importance of increasing revenue as a share of GDP and that closing the fiscal deficit is critical for further growth. The Government of Armenia is working on a strategy to increase revenue, and the U.S. Government will explore new mechanisms for working with the Government of Armenia and the National Assembly to support this strategy.

(4) The Government of Armenia will provide the U.S. Government with a copy of the Strategy for Sustainable Economic Development as soon as it is available. The U.S. Government, in coordination with other donors, will then work to complement the efforts of the Government of Armenia to achieve the stated priorities in this Strategy.

(5) The Government of Armenia will provide the U.S. Government with a copy of the latest draft Anti-Corruption Strategy as soon as it is available, anticipated to be November 2003. Although there was no U.S. Government input into the final draft that was approved on November 6, 2003, the U.S. Government, in coordination with other donors, will consider how it can best contribute to achieving the goals of the Anti-Corruption Strategy.

(6) The U.S. Government recognizes Armenia's progress on enterprise development, especially in the development of SMEs and the accompanying creation of over 10,000 jobs. Both sides agree that continued SME development and bringing them into the formal economy is critical to the creation of jobs and alleviation of poverty in Armenia. The U.S. Government, through USAID and USDA programs, will continue to provide assistance to entrepreneurs and micro and SME lending facilities, and - noting the Government of Armenia's interest in this program - will work with the EBRD to support SME development in Armenia.

(7) The U.S. Government will consult with the Government of Armenia, representatives of the Diaspora and other donors, including the World Bank, in sponsoring the design and implementation of a "Business Climate Review" that will evaluate constraints to foreign direct investment in Armenia. Upon completion of any survey undertaken in this regard, the U.S. Government will provide its results to the Government of Armenia, the High Business Council, the local business community and Diaspora representatives.

(8) The sides recognize the need to increase the level of financial intermediation in the economy. They also recognize that a major impediment to increased intermediation is the high level of "connected lending" in the Armenian economy. The U.S. Government will work with the Central Bank of Armenia to look for ways to strengthen the banking sector and the availability of long term credit, with the objective of increasing the provision of credit to SMEs, while addressing risk issues.

(9) The U.S. Government has reviewed the Government of Armenia's request to the U.S. Government to transfer repayments related to Armenia's concessional Pl 480

debt to Assistance Program budgets in Armenia. The U.S. Government, due to legal constraints, cannot respond positively to this request. No further actions are expected on this issue.

(10) Both sides recognize that, based on per capita income, Armenia could be eligible for funding under the Millennium Challenge Account (MCA), once the U.S. Congress passes the necessary legislation. The U.S. Government notes its desire to begin the MCA process as soon as possible and the Government of Armenia expresses its intent to strengthen its qualifications for, and prepare for possible participation in MCA.

(11) The U.S. Government recognizes the progress that Armenia has made on restructuring and privatizing its power sector, and will continue to work with the Government of Armenia to help it develop an energy strategy with concrete targets that provides safe, stable, and reliable energy to the Armenian people. The U.S. Government will also work with the Government of Armenia to develop heating alternatives and energy efficiency. The U.S. Department of Energy agrees to work with the Ministries of Energy and Foreign Affairs to organize an energy conference to discuss energy policy and investment in the energy sector.

(12) The U.S. Government agrees to continue to provide technical assistance to the Natural Monopolies Regulatory Commission. In particular, U.S. assistance will focus on ways to help it perform effectively in its expanded role as the Public Utilities Regulatory Commission.

(13) The U.S. Department of State will provide the Ministry of Finance and Economy, the Ministry of Justice, and the already-established Armenian interagency task force with detailed plans and requirements for the development of a Forensics Laboratory in Armenia. The Government of Armenia will work to expedite execution of the amended Letter of Agreement with the U.S. Government, which allows for additional law enforcement assistance.

(14) Both sides recognize that money laundering, while not an obviously identified problem in Armenia today, could become a problem in the future, especially if the number of bank transactions increases as anticipated. The U.S. Government encourages the Government of Armenia to prepare internationally acceptable legislation and implementation plans to address this issue now, and the U.S. Government, through the Treasury Department, will provide technical assistance as requested by the Government of Armenia.

(15) A representative from the U.S. Embassy will meet with Ministry of Foreign Affairs representative to review the status of Armenia's ratification of international counterterrorism conventions. The U.S. Government will consider providing technical assistance in this area if requested by the Government of Armenia.

(16) Both sides agree that weaknesses in rule of law and due process are impediments to economic growth, democratic development, and poverty reduction in Armenia. The Government of Armenia commits to strengthening the rule of law and due process, and welcomes U.S. Government assistance toward this end. Both sides will work together to address and improve these issues.

(17) The U.S. Government recognizes the positive progress made by the Government of Armenia in the area of trafficking in persons, as evidenced by Armenia's improved ranking in the U.S. State Department's most recent Trafficking in Persons Report. The Government of Armenia and the U.S. State Department will continue to cooperate on developing and implementing programs to combat trafficking in persons.

(18) Prior to the next meeting of the U.S.-Armenia Task Force, the Government of Armenia will seek ways to coordinate international assistance through the PRSP mechanism that will advance national development, economic reform, and cooperation. Noting the PRSP as a current priority for the GOAM, these coordination efforts will harmonize the PRSP, national anti-corruption plan and other proposed strategies for economic development.

(19) Both sides support the removal of Armenia from Jackson-Vanik as quickly as possible to reflect the progress made on both religious freedom and trade issues. The U.S. State Department will provide the Government of Armenia with a paper on the U.S. Administration's position on removal of Armenia from

the provisions of the Jackson-Vanik Amendment. Ambassador Ordway will hold a press conference in Yerevan to explain Jackson-Vanik and the status of trade relations between the U.S. and Armenia.

(20) The Government of Armenia will provide the U.S. Embassy with a compendium of WTO compliance issues. Upon receipt, the U.S. Government, in cooperation with other donors, will evaluate concrete assistance possibilities. Both sides recognize that enforcement of intellectual property rights is important. The U.S. Government is committed to providing technical assistance on IPR issues and will discuss with the GOAM possible technical assistance in other areas.

(21) The Government of Armenia agrees that use of any type of minimum value reference pricing violates its WTO commitments. The Government of Armenia will provide a written statement to the U.S. Embassy stating unequivocally that no computerized minimum value reference pricing system is in place in Armenia. The U.S. Government agrees to consider providing technical and other assistance to the relevant Armenian agencies to help address import valuations.

(22) Both sides acknowledge that problems existed when importing technical assistance and humanitarian commodities into Armenia under the Bilateral Agreement of 1992. Both sides agree that the following procedure will be followed whenever the U.S. Government and other covered parties want to import commodities under this Bilateral Agreement in order to make this process more effective:

--Every six months, the U.S. Embassy will submit to the State Customs Committee, the Ministry of Foreign Affairs, and the Ministry of Finance and Economy an updated list of organizations covered by the Bilateral Agreement, with reference to specific projects that are separately and periodically provided to the Ministry of Finance and Economy for its assistance database. The U.S. Embassy will designate a person who will walk through these steps to check the accuracy of the above mentioned database being kept by the Ministry of Foreign Affairs and the lists submitted to the Ministry to be sure the above system is effective. When the interim review is conducted in early 2004 this process will be reviewed to make sure it is working effectively.

--The U.S. Government agrees that normally the U.S. Embassy or an agency of the U.S. Government will submit a letter to the State Customs Committee (with a copy to the Ministry of Foreign Affairs) one month prior to arrival of a commodities shipment covered by the Bilateral Agreement, stating the details of the shipment (arrival date, if known, else in general terms when it will arrive; and the general nature of the shipment). The U.S. Government will endeavor to have the letters sent one month prior to arrival of a shipment, and the Government of Armenia will cooperate in clearing shipments when notice is given less than one month before arrival.

--If any Government of Armenia officials have any questions on shipments imported into Armenia that could or is claimed to be under the Bilateral Agreement, then these officials must notify the U.S. Embassy immediately according to procedures that will be provided to the Ministry of Foreign Affairs by the U.S. Embassy.

(23) The Minister of Finance and Economy agrees to rectify existing customs disputes as follows:

--AEAI attempted to import wood dryers under a U.S. assistance program on energy efficiency. Both sides acknowledge that this is a shipment of goods covered by the Bilateral Agreement. USAID agrees to submit a description of this project to the Ministry of Finance and Economy before November 7. The Ministry of Finance and Economy agrees to resolve this issue before November 14 by providing a letter allowing the import of these dryers under the Bilateral Agreement (i.e., without any taxes, customs duties, etc.). The Customs Chairman acknowledges that this letter from the Ministry of Finance and Economy will override any position taken by the Customs Committee concerning the import of these dryers. [Note: This case was resolved in mid-November and the wood dryers are now in the possession of the U.S. Government implementing partner].

--Counterpart International imported hygiene kits into Armenia, and has had problems with Customs officials concerning taxation of these commodities. The Ministry of Finance and Economy agrees to discuss this issue with the Prosecutor General's office, since this case has already been referred by Customs to the

Prosecutor's Office. The U.S. Embassy will assign a person to answer any questions on this topic for the Ministry of Finance and Economy. [Note: This case was resolved in mid-December and the hygiene kits are now in the possession of the U.S. Government implementing partner]

(24) Both sides agree that two sub-committees - a Science Panel and a Trade and Investment Panel - of the U.S. Armenia Economic Task Force will be created before the next US-Armenia Economic Task Force meeting. The Government of Armenia and the U.S. Government will designate points of contact that will report back to the Minister of Trade and Finance and the U.S. Embassy directly on progress made. These Panels will be prepared to hold initial meetings at the next US-Armenia Economic Task Force meeting, if not before.

(25) Both sides acknowledge that there will be no U.S. government monetization programs for Armenia in FY04. Prior to the due date for program proposals for FY05 programs, the U.S. will discuss any possible proposals with project proponents, inviting consultation with the Ministry of Finance and Economy and related state agencies where appropriate. If the U.S. Embassy supports these proposals, then it will discuss these with the Office of the Prime Minister. If the Prime Minister provides written assurance to the U.S. Embassy at least six months prior to the beginning of FY05 (April 1, 2004) that the Government of Armenia will support these programs under the Bilateral Agreement, meaning that no customs, VAT, unreasonable storage fees, or other import duties will be imposed, then the U.S. Embassy will convey its support for these proposals to the approving office within the U.S. Government. Both sides acknowledge that such a recommendation by the U.S. Embassy will not guarantee that a project will be selected by the U.S. Government agency overseeing a monetization program.

(26) The Government of Armenia is aware that any taxation of U.S. assistance by the Government of Armenia will be subject to a reduction in U.S. assistance levels. Both sides agree to work together to avoid any taxation of U.S. assistance, and will actively review any potential taxation issues in order to resolve the issue quickly.

End text.

ORDWAY